No. 84-1792

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IN THE

Supreme Court of the United States

October Term, 1984

SWEATER BEE BY BANFF, LTD.,

Petitioner,

v.

MANHATTAN INDUSTRIES, INC. and
BAYARD SHIRT CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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June 12, 1985

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QUESTION PRESENTED

Did the District Court and the Court of Appeals properly hold that respondents had not waived arbitration where pursuant to the terms of a consent judgment agreed to by petitioner, respondents raised arbitration as a defense in their answer, moved promptly for a stay of proceedings and, prior to answering, had taken no discovery and made only a motion to dismiss pursuant to Fed.R.Civ.P. 12(b)(6)?

TABLE OF CONTENTS

	PAGE
Question Presented	i
Table of Authorities	iii
Opinion Below	1
Jurisdiction	1
Statement of the Case	2
Reasons Why the Writ Should be Denied	2
I. The Decision of the Court of Appeals is Consistent With This Court's Decisions Supporting the Strong Federal Policy Favoring Arbitration	2
II. The Rule of Law Regarding Waiver Petitioner Urges Would Significantly Undercut the Federal Policy Favoring Arbitration	6
Conclusion	10

TABLE OF AUTHORITIES

CASES	PAGE
Adickes v. S. H. Kress & Co., 398 U.S. 144 (1970)	4
Canadian Overseas Ores Ltd. v. Compania De Acero Del Pacifico, S.A., 727 F.2d 274 (2d Cir. 1984)	7
Carcich v. Rederi A/B Nordie, 389 F.2d 692 (2d Cir. 1968)	3
Carolina Throwing Co. v. S&E Novelty Corp., 442 F.2d 329 (4th Cir. 1971)	6
Clar Productions, Ltd. v. Isram Motion Pictures Production Services, Inc., 529 F.Supp. 381 (S.D.N.Y. 1982).	7
Dean Witter Reynolds Inc. v. Byrd, 53 U.S.L.W. 4222 (March 4, 1985)	9
Dickinson v. Heinold Securities, Inc., 661 F.2d 638 (7th Cir. 1981)	3
Gavlik Construction Co. v. H. F. Campbell Co., 526 F.2d 777 (3rd Cir. 1975)	6
General Guaranty Insurance Co. v. New Orleans General Agency, Inc., 427 F.2d 924 (5th Cir. 1970).....	7
Germany v. River Terminal Railway, 477 F.2d 546 (6th Cir. 1973)	3
Hart v. Orion Insurance Co., 453 F.2d 1358 (10th Cir. 1971)	3, 6
Haupt v. Rose, 265 N.Y. 108 (1934)	8
Hilti, Inc. v. Oldach, 392 F.2d 368 (1st Cir. 1968)	7
J&S Construction Co., Inc. v. Travelers Indemnity Co., 520 F.2d 809 (1st Cir. 1975).....	6
Jones Motor Co. v. Chauffeurs Local Union, 671 F.2d 38 (1st Cir. 1982).....	8
Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942).....	3
Lawn v. United States, 355 U.S. 339 (1958).....	4

CASES	PAGE
Lubrizol International, S.A. v. M/V Stolt Argobay, 562 F.Supp. 565 (S.D.N.Y. 1982)	7, 8
Lumbermens Mutual Casualty Co. v. Borden Co., 268 F.Supp. 303 (S.D.N.Y. 1967)	7
Midwest Window Systems v. Amcor Industries, Inc., 630 F.2d 535 (7th Cir. 1980)	3, 6
Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983)	2, 3
Necchi Sewing Machine Sales Corp. v. Carl, 260 F.Supp. 665 (S.D.N.Y. 1966)	7, 8
Neely v. Martin K. Eby Construction Co., 386 U.S. 317 (1967)	4
Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959) *cert. dismissed*, 364 U.S. 801 (1960)	7
Shinto Shipping Co., Ltd. v. Fibrex & Shipping Co., Inc., 572 F.2d 1328 (9th Cir. 1978)	6
United Steelworkers v. American Manufacturing Co., 363 U.S. 564 (1960)	4, 5
United Steelworkers v. Enterprise Wheel and Car Corp., 363 U.S. 593 (1960)	4
United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960)	4, 5
Weight Watchers of Quebec Ltd. v. Weight Watchers International, Inc., 398 F.Supp. 1057 (E.D.N.Y. 1975)	7
STATUTES	
Labor Management Relations Act § 301, 29 U.S.C. § 185(a)	4
FEDERAL RULES OF CIVIL PROCEDURE	
Rule 12(b)(6)	*passim*

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OPINION BELOW

The Opinion of the United States Court of Appeals for the Second Circuit is reported at 754 F.2d 457 (2d Cir. 1985). The Order of the District Court for the Southern District of New York appears in Petitioner's Appendix B.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

STATEMENT OF THE CASE

The facts and prior proceedings in the case are stated fully in the decision of the Court of Appeals, 754 F.2d at 458-60.

REASONS WHY THE WRIT SHOULD BE DENIED

This case presents no issues worthy of certiorari.

The parties agreed in a consent judgment terminating a prior litigation to arbitrate "[a]ll disputes under or arising out of this judgment. . . ." The question presented to and decided by the Court of Appeals was whether respondents, by certain limited activity in this action prior to filing an answer to the amended complaint demanding arbitration, had waived their right to arbitration. The Court of Appeals, in a thorough, well reasoned opinion soundly based on clear and long-standing precedent, affirmed the District Court's finding of no waiver. There is no reason for this Court to disturb this decision, which is wholly consistent with this Court's numerous decisions supporting the strong federal policy favoring arbitration.

Petitioner's suggested modification of the law of waiver, which it conceded below is not based on even a single case, would unsettle the law of waiver and undercut the effectiveness of arbitration.

I. THE DECISION OF THE COURT OF APPEALS IS CONSISTENT WITH THIS COURT'S DECISIONS SUPPORTING THE STRONG FEDERAL POLICY FAVORING ARBITRATION

This Court's consistent endorsement of the strong federal policy favoring arbitration was explicitly relied upon and underlies the opinion of the Court of Appeals in this action. The Court of Appeals explicitly followed the mandate expressed in this Court's opinion in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983), regarding the proper approach for a federal court considering questions relating to arbitration. 754 F.2d at 461. In *Moses H. Cone*, this Court stated:

> [T]he Courts of Appeals have . . . consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We

> agree. The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability. 460 U.S. at 24-25.

In a footnote to this text, this Court cited with approval a number of cases, including three cases dealing with waiver of arbitration. 460 U.S. at 25 n.31. One of these cases was a 1971 decision of the Tenth Circuit, *Hart v. Orion Insurance Co.*, 453 F.2d 1358 (10th Cir. 1971), in which that Court, rejecting a claim of waiver, stated that "[i]n view of the overriding federal policy favoring arbitration, waiver is not lightly inferred." *Id.* at 1360. The Tenth Circuit's opinion relied upon *Carcich v. Rederi A/B Nordie*, 389 F.2d 692 (2d Cir. 1968), and held that "[t]he question of waiver turns on the presence or absence of prejudice." 453 F.2d at 1361.[1] The analysis and precedent relied upon in the Court of Appeals' opinion in this case is completely consistent with the *Hart* decision and the other waiver cases cited by the Court in *Moses H. Cone*.[2] Indeed, the Second Circuit's opinion below explicitly follows *Carcich* and *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978 (2d Cir. 1942), the leading case on waiver in that Circuit, from which Judge Kaufman stated *Carcich* followed "a fortiori". *See* 754 F.2d at 461; 389 F.2d at 695.[3] The Court of Appeals also observed that "[t]he case at bar also follows a fortiori from *Kulukundis*. . . ." 754 F.2d at 462.

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[1] As will be demonstrated *infra* at 5-6, there is a complete absence of prejudice to petitioner.

[2] In *Germany v. River Terminal Railway*, 477 F.2d 546, 547 (6th Cir. 1973), the Sixth Circuit, finding no waiver of arbitration, stated: "waiver may not be inferred from the fact that a party does not rely exclusively on the arbitration provisions of a contract, but attempts to meet all issues raised in litigation between it and another party to the agreement." The Seventh Circuit in *Dickinson v. Heinold Securities, Inc.*, 661 F.2d 638 (7th Cir. 1981), found no waiver despite a delay of eighteen months in seeking arbitration and noted that " 'waiver of arbitration is not lightly to be inferred.' " *Id.* at 641 (quoting *Midwest Window Systems v. Amcor Industries, Inc.*, 630 F.2d 535, 536 (7th Cir. 1980)).

[3] We note that petitioner neither cites any Court of Appeals decision inconsistent with the opinion below nor claims that the opinion below conflicts with that of any other Circuit.

Petitioner contends the Court of Appeals' opinion conflicts with this Court's opinion in *United Steelworkers v. American Manufacturing Co.*, 363 U.S. 564 (1960), because it permits "judicial intrusion into the merits of arbitrable controversies" which petitioner asserts is prohibited by *American Manufacturing*.[4] (Petition at 13.) This assertion is curious on its face, in that petitioner seeks *not* to protect its right to an arbitral decision, but to deprive *respondents* of their bargained-for right to arbitration.

Moreover, *American Manufacturing*, a case involving arbitration in the unique context of a collective bargaining agreement under § 301 of the Labor Management Relations Act, is clearly distinguishable. The opinions in *American Manufacturing* and the two companion cases relating to labor arbitrations decided the same day by the Court, *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960), and *United Steelworkers v. Enterprise Wheel and Car Corp.*, 363 U.S. 593 (1960), make clear that labor arbitrations are designed to further the goal of industrial peace and are, therefore, distinctly different in purpose and nature from the sort of commercial arbitration at issue here. For example, in the *Warrior & Gulf* case, the Court stated:

> "In the commercial case, arbitration is the substitute for litigation. Here arbitration is the substitute for industrial strife. [A]rbitration of labor disputes has quite different functions from arbitration under an ordinary commercial agreement. . . . For arbitration of labor disputes under collective bargaining agreements is part and parcel of the collective bargaining process itself." 363 U.S. at 578.

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[4] Petitioner did not raise this issue in the Court of Appeals, nor did it cite *American Manufacturing* below. Its failure to present this issue to the Court of Appeals precludes it being raised in this Court for the first time. As this Court stated in *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970), "[w]here issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them." *Accord Neely v. Martin K. Eby Construction Co.*, 386 U.S. 317, 330 (1967); *Lawn v. United States*, 355 U.S. 339, 362 n.16 (1958).

Indeed, the *Warrior & Gulf* Court specially stated that "the run of arbitration cases, illustrated by *Wilko v. Swan*, 346 U.S. 247, . . . [is] irrelevant to our problem." *Id.*[5]

Unlike the unions in *American Manufacturing* and its companion cases, petitioner here does not seek to vindicate its right to arbitrate. Rather, it claims that a waiver of arbitration as to all arbitrable claims should be found because the District Court was presented with a motion to dismiss by respondents. Nor does petitioner challenge the District Court's decision on the motion as incorrect or seek to reverse its ruling. That is not surprising since the District Court's rulings were primarily favorable to petitioner. Indeed, only a single frivolous arbitrable claim in its thirty-count complaint was dismissed.[6] As the Court of Appeals stated, respondents were "almost totally unsuccessful on [their] motion to dismiss." 754 F.2d at 466. Thus, even if the *American Manufacturing* trilogy were applicable to this commercial context, it offers petitioner, which seeks not to enforce its right to an arbitral decision but to avoid arbitration altogether, no solace.

The fact that petitioner emerged from the motion to dismiss virtually unscathed also means that it, as the Court of Appeals held, is unable to assert a critical element of its heavy waiver burden—prejudice. 754 F.2d at 463. The Court of Appeals, in accordance

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[5] This theme was echoed in the separate opinion of Justices Brennan and Harlan, joined in by Justice Frankfurter: "The Court rightly concludes that appropriate regard for the national labor policy and the special factors relevant to the labor arbitral process, admonish that judicial inquiry into the merits of this grievance should be limited. . . ." 363 U.S. at 572.

[6] This purported claim which the Court of Appeals found was "at best frivolous", 754 F.2d at 463, was for interference with contractual relations. The Court of Appeals stated: "Sweater Bee knew or should have known that such a claim requires an actual and existing contract and knowledge of that contract, neither of which conditions were alleged here." 754 F.2d at 463. Significantly, petitioner has never contended that the Court's decision as to this claim was incorrect. Nor is it conceivable that any arbitrator could have come to a different conclusion.

with the consistent law in the Second Circuit and elsewhere,[7] specifically addressed whether there was any prejudice to petitioner, and found essentially none. *See* 754 F.2d at 463-65. Nor does the petition address the question of prejudice, except in a purely theoretical fashion. (*See* Petition at 18-21.) The reality is that petitioner, as the Court of Appeals pointed out, 754 F.2d at 463, is in essentially the same position it would have been if respondents had requested arbitration before moving to dismiss.[8]

II. THE RULE OF LAW REGARDING WAIVER PETITIONER URGES WOULD SIGNIFICANTLY UNDERCUT THE FEDERAL POLICY FAVORING ARBITRATION

Petitioner suggests that the Court should hold that any Rule 12(b)(6) motion directed to the merits, *i.e.* any motion for failure to state a claim, should be deemed an automatic waiver of arbitration. Petitioner gives no cogent reason why this Court should overturn over forty years of precedent in the Second Circuit and elsewhere, and thereby reduce the number of disputes to be heard in arbitration. Such a holding, we submit, would be directly contrary to the strong federal policy of encouraging arbitration.

Moreover, the rule petitioner suggests would significantly undercut the expectations of litigants based on current law. Witness the example of respondents here. Respondents acted precisely as the Federal Rules of Civil Procedure and case law regarding waiver of

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[7] *See, e.g., J&S Construction Co., Inc. v. Travelers Indemnity Co.*, 520 F.2d 809, 810 (1st Cir. 1975); *Gavlik Construction Co. v. H. F. Campbell Co.*, 526 F.2d 777, 783 (3rd Cir. 1975); *Carolina Throwing Co. v. S&E Novelty Corp.*, 442 F.2d 329, 331 (4th Cir. 1971); *Midwest Window Systems v. Amcor Industries, Inc.*, 630 F.2d 535, 537 (7th Cir. 1980); *Shinto Shipping Co., Ltd. v. Fibrex & Shipping Co., Inc.*, 572 F.2d 1328, 1330 (9th Cir. 1978); *Hart v. Orion Insurance Co.*, 453 F.2d 1358, 1361 (10th Cir. 1971).

[8] Indeed, petitioner, which has substantially benefitted from discovery conducted while respondents' motion for reargument was pending, is probably in a better position. This discovery was heavily relied upon by petitioner in making its motion for contempt. Moreover, it has had the benefit of that discovery in the civil contempt proceeding now being conducted.

arbitration permit—before answering, as is specifically provided in Rule 12(b)(6),[9] they moved to dismiss for failure to state a claim—then when they did file their answer, they pleaded arbitration as a defense to Sweater Bee's source reference claims. As the Court of Appeals indicated, "[n]ot a single case cited serves to put Manhattan on notice that a defendant's failure to file a request for arbitration before answering would constitute a waiver of his conceded right to obtain arbitration in connection with the arbitrable claims advanced." 754 F.2d at 466. Indeed, case law in the Second Circuit is uniformly to the effect that no waiver can be found until *after* the defendant files its answer. *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 412-13 (2d Cir. 1959) *cert. dismissed*, 364 U.S. 801 (1960); *Clar Productions, Ltd. v. Isram Motion Pictures Production Services, Inc.*, 529 F. Supp. 381, 383 (S.D.N.Y. 1982); *Lumbermens Mutual Casualty Co. v. Borden Co.*, 268 F. Supp. 303, 312 (S.D.N.Y. 1967); *Necchi Sewing Machine Sales Corp. v. Carl*, 260 F. Supp. 665, 668 (S.D.N.Y. 1966). *Accord, General Guaranty Insurance Co. v. New Orleans General Agency, Inc.*, 427 F.2d 924, 929 n.5 (5th Cir. 1970) (burden of showing waiver is "heavy" if defendant has given notice of arbitration in the answer); *Hilti, Inc. v. Oldach*, 392 F.2d 368, 371 (1st Cir. 1968).

The "intricate" amended complaint contained thirty claims, including seventeen antitrust claims and nineteen nonarbitrable claims relating to alleged fraud in the prior trademark action. Faced with this plethora of claims, many of them frivolous,[10] respondents "not surprisingly" moved to dismiss. *See* 754 F.2d at 466.

Petitioner complains that the Court of Appeals' distinction between summary judgment and rule 12(b)(6) motions "makes no sense for purposes of arbitration waiver." (Petition at 31.) However, that distinction is clearly established in the waiver case law[11] and is

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[9] *See*, 754 F.2d at 463.

[10] Confronted with the motion, petitioner withdrew four claims and part of another. The District Court dismissed three claims (only one of which was arbitrable) and portions of two claims.

[11] *See, e.g., Weight Watchers of Quebec Ltd. v. Weight Watchers International, Inc.*, 398 F.Supp. 1057, 1060 (E.D.N.Y. 1975); *Lubrizol International, S.A. v. M/V Stolt Argobay*, 562 F.Supp. 565, 573 (S.D.N.Y. 1982); *cf. Canadian Overseas Ores Ltd. v. Compania De Acero Del Pacifico S.A.*, 727 F.2d 274, 277-78 (2d Cir. 1984) (defense of foreign sovereign immunity not waived by motion to dismiss).

designed to result in a waiver when the party making the motion invites the Court, rather than an arbitrator, to decide the factual merits of the controversy between the parties.[12] Here, as in virtually all 12(b)(6) motions, the District Court merely determined the sufficiency *vel non* of a pleading—it did not delve into the facts, nor did respondents invite such a factual inquiry. Indeed, the District Court's memorandum specifically stated that it would not treat the motion as one for summary judgment.[13] (A-32)

Petitioner makes a number of "judicial economy" policy arguments to support its position that a waiver should be found in this case. As the Court of Appeals observed, petitioner's claim that the District Court order compelling arbitration would disserve judicial economy is "surely a rather surprising thought for those who have followed the arbitration versus litigation arguments of the last several decades." 754 F.2d at 465. Notwithstanding that telling observation, all petitioner's judicial economy arguments were discussed by the Court of Appeals which rejected them in convincing fashion. For example, petitioner's "forum shopping" argument was fully considered by the Court which indicated that the claimed prejudice to plaintiff was "highly speculative, if not illusory." 754 F.2d

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[12] Or as the *Lubrizol* Court put it, "asks [the] Court to be the final arbiter of the dispute. . . ." 562 F.Supp. at 573; *accord, Jones Motor Co. v. Chauffeurs Local Union*, 671 F.2d 38, 44 (1st Cir. 1982) (waiver held where Union moved for summary judgment and "was ready to accept the determination of the district court on the merits. . . .").

[13] Petitioner seeks to ignore this distinction between factual determinations and motions directed to the sufficiency of pleadings arguing they both go "to the merits." However, it cites no cases holding that motions to dismiss can be a basis for waiver. Indeed, the only two waiver cases found by either party in which a defendant made a motion directed to the sufficiency of the pleadings found no waiver. *Haupt v. Rose*, 265 N.Y. 108 (1934) and *Necchi Sewing Machine Sales Corp. v. Carl*, 260 F.Supp. 665, 666 (S.D.N.Y. 1966) (in which defendant made a demurrer based, *inter alia*, on the failure to state a cause of action). In both these cases, the motions were denied and the courts found that the defendants' actions did not constitute waiver of their right to arbitrate. 265 N.Y. at 110; 260 F.Supp. at 668. Petitioner seeks to distinguish these cases as "not on the merits". (Petition at 17-18.) Defendant's demurrer in *Necchi* was directed to the merits of the claim, however, and was the equivalent of a 12(b)(6) motion. *See*, 754 F.2d at 465; Fed. R. Civ. P. 12 advisory committee note. Nor does the *Haupt* Court's discussion of waiver support petitioner's distinction.

at 464-65. In addition, if a plaintiff (unlike petitioner) sincerely wishes to avoid a judicial determination of its arbitrable claims, there is a simple solution to the supposed dilemma—once defendant moves to dismiss, plaintiff can simply request arbitration. Plaintiff can also seek arbitration in the first instance. Sweater Bee, of course, did not do so—it has always sought to *avoid* its firm agreement to arbitrate and to pursue its claim solely in a judicial forum.

The Court of Appeals also considered and rejected petitioner's argument that the Court's decision would encourage unnecessary 12(b)(6) motions. The Court, which followed decades of authority regarding waiver, stated: "[w]e see no signs of this, nor do we think it will take place." 754 F.2d at 465. Indeed, the considerable risk that a court may treat the motion as one for summary judgment is a significant deterrent to most such motions. *Id.*

Finally, the Court of Appeals, while recognizing that in some instances a district court may have to review an arbitrator's decision to determine whether it conforms to the court's 12(b)(6) decision, observed that the problem was "essentially the same" in any case where a Court was asked to enforce or vacate an arbitral award. 754 F.2d at 465-466. In addition, since the issues raised in this action have arisen out of an Order of the District Court, that Court may well have an obligation to see that the arbitrator has not misinterpreted the Order.

Even if petitioner's "judicial economy" arguments were persuasive, this Court's recent opinion in *Dean Witter Reynolds Inc. v. Byrd*, 53 U.S.L.W. 4222 (March 4, 1985), clearly holds that the federal courts must enforce arbitration agreements "even where the result would be the possibly inefficient maintenance of separate proceedings in different forums." 53 U.S.L.W. at 4223. The Court, in enforcing an agreement to arbitrate, explicitly rejected precisely the type of judicial economy arguments petitioner makes here in support of its effort to escape its undisputed agreement to arbitrate. *Id.* at 4223-24.

Moreover, it is significant that petitioner's "judicial economy" agruments, while purporting to be in furtherance of the federal policy favoring arbitration, are calculated to undercut that policy by expanding the prospects for waiver. Current waiver law imposes a "heavy burden" on one asserting waiver, *see* 754 F.2d at 466, but

petitioner would eliminate or radically reduce this burden. The inevitable result would be less disputes arbitrated and more litigation in the federal courts. Such a result is clearly contary to the clear, emphatic federal policy favoring arbitration as expressed by Congress in the Arbitration Act and by this Court in numerous opinions.

CONCLUSION

This case was correctly decided by the Court of Appeals for the Second Circuit. The decision does not conflict with decisions of the Supreme Court or of other Circuits. In contrast, the result petitioner suggests is inconsistent with existing case law regarding waiver of arbitration and the strong federal policy favoring arbitration. For these reasons, respondents respectfully request that the Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit be denied.

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